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TAGS: EFIN ECON RS
SUBJECT: GOR BAILOUTS DONE, DEBT RESTRUCTURING NOW FLAVOR
OF THE YEAR; "MOSCOW RULES" COMING?

REF: A. MOSCOW 859
¶B. MOSCOW 743
¶C. MOSCOW 621
¶D. MOSCOW 534
¶E. (08) MOSCOW 1775

Classified By: ECON MC Eric T. Schultz, Reasons 1.4 (b/d).

Summary

¶1. (C) As we have previously reported (Refs A - D), the GOR has made a major change in policy in the last two months with respect to assisting cash-strapped Russian firms with their foreign debts. Several recent cases have made clear that the GOR is serious and that these firms can no longer expect large state bailouts. They should instead seek to restructure their foreign debts. Finance Leasing Company (FLC), a tiny aircraft leasing firm, recently became the first Russian state-owned company in more than a decade to default on foreign debt. Privately owned UC Rusal, an aluminum giant, is continuing debt-restructuring negotiations with more than 70 creditors after GOR officials said they would not bail out the cash-poor company. Alfa Bank, Russia's largest private bank, was Rusal's only creditor not to agree to the standstill partly because it too is hurting for cash, partly because of the GOR's policy change. The authorities' decision to stop bailing out Russian firms should reduce pressure on Russia's resources, including its reserves, which have fallen about $215 billion since last August. However, the decision raises concerns among Western bankers, who are turning to the GOR for assurances in default and near-default situations. Several recently told us that 2009 and 2010 promise to be "years of restructuring" as Russian companies attempt to unwind large debt positions built since 2006. End summary.

GOR Encourages Restructurings to Preserve Resources

¶2. (C) The GOR has enough reserves to forestall another run on the ruble, help Russian companies refinance debt on a large scale, or fund large budget deficits for the next two years. However, it does not have the resources to address all of these challenges. As we have previously reported, the GOR made the decision in recent months that it would no longer bailout cash-strapped Russian firms but would instead focus its remaining resources on social spending through a sizable budget deficit funded out of its foreign exchange reserves. Finance Minister Kudrin's Assistant, Vadim

Grishin, confirmed to us in March that the Ministry was firmly signaling to both the companies and their creditors that there would be no government bailouts. They would have to restructure or deal with the consequences of defaults.

¶3. (C) Alexey Novikov, Standard and Poor's managing director for Russia, told us contingent liabilities are a "big part of the story," and the GOR's belated recognition that its reserves cannot cure all was probably why it had changed its policy on bailouts. Novikov said the sovereign's investment grade rating was still probably safe as long as reserves stayed above $300 billion and, like many local analysts, predicted that the GOR would let the ruble fall if it again came under pressure rather than running reserves down further. That said, he could not rule out a credit downgrade even if reserves held steady should the ruble depreciate further amid indications that the budget deficit would be larger than expected, causing the macroeconomic environment to worsen significantly.

Little-Known Company Creates Big Stir

¶4. (C) Grishin told us candidly that the FLC case illustrated the GOR's resolve to maintain its new strategy toward cash-poor firms and their foreign debts. In December, FLC became the first Russian state-owned firm to default on foreign debt in more than a decade when it missed interest payments on bonds worth $250 million. The GOR, which owns about 80 percent of the company directly and through the United Aircraft Corporation, the state-aerospace holding, gave no indication it would bail out creditors, even though investors in FLC's debt include about 50 foreign and Russian financial institutions. UAC board member and Deputy Prime Minister Sergey Ivanov later said UAC would help FLC "settle the issue," but again gave no indication the GOR would make good on the firm's debt.

¶5. (C) UralSib Chief Strategist Chris Weafer told us the case was a "shot across the bow" for creditors and a firm signal that the GOR would not bail out Russian enterprises and their foreign creditors.

The Rusal Saga Continues

¶6. (C) Rarely does a day pass in Moscow when Rusal, its affiliates, and Oleg Deripaska, its primary owner, do not make headlines with regard to the company's massive debts, much of it denominated in foreign currencies. The latest headline was an agreement in late March by Mikhail Prokhorov's Onexim Group to boost its stake in Rusal to almost 20 percent as part of a very favorable (to Rusal) restructuring of $2.8 billion owed by the aluminum firm. Prokhorov is rumored to have agreed to these terms under GOR pressure, given that the deal was based on what most analysts considered a grossly inflated current market value for Rusal of $45 billion.

¶7. (C) The aluminum company and related firms owe creditors at least $15 billion, including $7.5 billion due to foreigners this year, and may be as much as $30 billion in debt, although the exact number is anybody's guess. Citi's Russian Country Officer Zdenek Turek and HSBC Russia CEO Stuart Lawson told us that nobody knows how much Deripaska owes, including Deripaska himself. According to our contacts, foreign investors are watching the Deripaska case closely, viewing it as a test case for how the GOR will respond to other major Russian enterprises. Alfa Bank Chief Economist Natalia Orlova told us that the Rusal case would be a key indicator of how willing the GOR is to be a good business partner because of its close ties to the private company. She said only 10-15 percent of investors understand the firm is bankrupt, and that many foreign banks demanding

that they be repaid are probably doing so in vain. If Rusal defaults on large chunks of this debt, according to Orlova, its creditors would probably reduce lending to Russian firms for years, even if global credit markets open soon.

¶8. (SBU) Recognizing the gravity of Rusal's situation, First Deputy Prime Minister Shuvalov in late March publicly said the GOR might allow Deripaska to pay foreign creditors of Rusal with shares of the company. This would mark a major shift for the government, which has made keeping major Russian assets in Russian hands a primary goal of the GOR's anti-crisis efforts to date. The GOR, for instance, loaned Deripaska $4.5 billion last fall (due to be repaid later this year) to pay a consortium of foreign banks who were threatening to seize a large part of his Rusal stake, which he had pledged for a large purchase of Norilsk Nickel. Shuvalov's admission that the GOR is open to greater foreign ownership of Rusal, and other recent comments from Shuvalov that the GOR "overpaid" Deripaska late last year are further indications of the GOR's policy change.

Fridman in Trouble?

¶9. (SBU) Rumors are also rife that Alfa, controlled by Mikhail Fridman, is in trouble. As we recently reported (Ref A), the core bank appears to be deeply concerned about a rising percentage of non-performing loans (NPLs). Alfa's CEO, Petr Aven, went so far as to suggest in early April in an interview with Russian business daily Vedomosti that the bank would be willing to sell almost 50 percent of its shares to the state in return for recapitalization funds. In addition, Alfa Bank's parent, Alfa Group, borrowed more than $2 billion late last year from the GOR to ensure Alfa's stake in Vimpelcom--Russia's second largest telecom provider--did not fall into foreign hands because Fridman had pledged a large stake of the company as collateral for a foreign loan. Then earlier this month, Alfa became the only major Rusal creditor to refuse the so-called standstill agreement with Deripaska. Fridman later backed off his hard-line position toward Deripaska, issuing a statement that the two were seeking a "mutually acceptable" solution, but questions about Alfa's financial health remain.

¶10. (C) Merrill Lynch Chief Economist Julia Tsepliaeva told us that Alfa could be a "big domino going down," and its collapse could reverberate through the entire economy. She said that the parent company and Fridman were highly leveraged, citing Fridman's recent closing of his London-based hedge fund and Alfa's large exposure to Ukraine. Alexey Moiseev, Renaissance Capital's fixed income research director, echoed this view, saying that a moratorium on corporate debt payments is likely in Ukraine, which would have a major negative impact on Alfa. If foreign creditors find themselves in restructuring talks with Fridman and Alfa, they may look back on the Deripaska negotiations nostalgically -- Fridman's track record on TNK-BP (Ref E) and Norwegian telecom company Telenor (Ref B) speak for themselves.

"London Rules" in Moscow?

¶11. (C) Russia HSBC CEO Stuart Lawson at a banking conference in late March called for the creation of a commission that would help firms like FLC, Rusal, and Alfa restructure debts. Lawson said the commission would be modeled on the "London Rules" (aka London Approach) for debt restructuring (N.B. The London Rules are a set of non-binding principles designed by the Bank of England in the 1970s -- updated in the 1990s -- to guide large-scale debt restructuring, ensuring that viable companies survive and minimizing losses to financial institutions). Lawson said a "Moscow Rules" commission would help define creditors' rights and make use of lessons learned from past restructurings to ensure an orderly process.

Grishin confirmed to us that talks on such a commission were under way but said no agreement was imminent.

¶12. (C) Lawson told us privately that he sits on a bank coordinating committee working with Deripaska on the Rusal debt. The committee includes the western banks with significant exposure (in the $200-400 million range for each bank) to Rusal debt, including Royal Bank of Scotland, Societe Generale, Citibank, Ceylon, and BNK Paribas. Lawson said Shuvalov and First Deputy Prime Minister Sechin had both spoken to the Western institutions, emphasized the GOR's new policy, and made clear that they would need to agree to the standstill agreement or deal with the consequences.

¶13. (C) Lawson added that he personally favored the standstill agreement, without which the foreign banks would have been frozen out of the restructuring process. That might have resulted in a situation like that of the Yukos affair, where the foreign banks had been required to abrogate their claims in order to get anything back on their loans. With the standstill agreement and the possibility of a more orderly restructuring, the foreign banks at least had a chance at acquiring a portion of Rusal's underlying assets, rather than see them slide back to the state or political insiders, with "dirty hands" all over the deal.

Comment

¶14. (C) The GOR's change in policy comes at a time when would-be creditors have already negatively re-evaluated their risk appetite for emerging markets and for Russia in particular. In the short term, the GOR's decision not to provide bailout support probably has little effect on sentiment. Lenders are already demanding much higher risk premiums to lure them away from quality, and prospective sources of financing for Russian firms will probably wait out the crisis regardless. Capital inflows to Russia are therefore expected to be virtually non-existent until the economy begins to recover. However, longer term, the outcome of the restructuring negotiations taking place this year and expected to continue into 2010 could affect lender sentiment toward Russia leading to still further increases in the risk premiums on Russian debt. This in turn could slow Russia's economic recovery when it does occur, given the economy's continuing dependence on foreign capital. End comment.
BEYRLE